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ILLINOIS COMMERCE COMMISSION

Docket 00-0132

Illinois Gas Company

Petition for Approval of Long Term Financing

Prepared Testimony of

Paul G. Neff, Assistant Treasurer

January, 2000

ILLINOIS
COMMERCE COMMISSION
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ILL. C. C. DOCKET NO. 00-0132

Petitioner's Exhibit No. 1

Witness Paul Neff

Date 4-25-00 Reporter ad

EXHIBIT

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1 Q. Please state your name, business address, and business telephone number.

2 A. My name is Paul G. Neff. My business address is 1004 State St., P. O. Box 596,
3 Lawrenceville, IL 62439. The telephone number is 618.943.3326.

4 Q. Mr. Neff, by whom are you employed and in what capacity?

5 A. I am employed by Illinois Gas Company ("Illinois Gas" or "the Company") as the Assistant
6 Treasurer and Comptroller.

7 Q. What are your duties as Assistant Treasurer and Comptroller?

8 A. I am responsible for all accounting functions for the Company; serve as Network
9 Administrator for the computer operations; and manage the Company's finances including
10 daily cash management and controlling borrowed funds.

11 Q. Have you previously testified before this Commission?

12 A. Yes, on several occasions.

13 Q. Would you please describe the purpose of this petition?

14 A. Yes. On August 2, 1989, this Commission entered an Order in Docket 89-0212, and
15 approval was granted for Illinois Gas to borrow \$2,200,000.00 from the Olney Savings
16 and Loan Association, which consisted of a \$1,200,000.00 loan secured by a mortgage
17 and a \$1,000,000.00 revolving line of credit. As the line of credit expired on August 2,
18 1999, the Company has reviewed its debt structure, and is now seeking Commission
19 approval for \$3,200,000.00 in loans from Community Bank and Trust, NA which is the
20 successor to Olney Savings and Loan Association, and is located at 240 E. Chestnut St.,
21 P. O. Box 700, Olney, IL 62450.

22 Q. Do you believe that Illinois Gas has a current need to borrow \$3,200,000.00?

23 A. Yes.

24 Q. Why?

25 A. As shown by the following table, Illinois Gas has added \$5,120,246 to it's Plant in Service
26 since our initial long term financing was approved by this Commission in Docket 89-0212:
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28

	<u>Year</u>	<u>Net Additions</u>	<u>Plant in Service Balance</u>
1	1990	\$ 461,317	\$ 8,114,858
2	1991	369,950	8,484,808
	1992	361,041	8,845,849
3	1993	519,212	9,365,061
	1994	673,388	10,038,449
4	1995	514,025	10,552,474
	1996	718,016	11,270,490
5	1997	733,310	12,003,800
	1998	770,287	12,774,087
6	Total	\$ 5,120,246	

Source: ICC Form 21

Although some of the additions to Plant in Service were funded by increasing stockholder's equity, depreciation and deferred taxes, the Company has had to incur additional debt. Attached is Exhibit 2, "Short and Long Term Note Balances", which indicates that there was very little short term borrowing by the Company between the second quarter of 1989 (which followed the entry of an Order in Docket 89-0212) and the third quarter of 1995. However, since that time, the Company has utilized unsecured short term debt, and it has become almost permanent.

Q. What is the primary source of spending for the plant additions explained above?

A. The majority of the funds were expended for the upgrading of our distribution system. We have been systematically replacing our low pressure, uncoated steel mains and service lines with intermediate pressure polyethylene mains and services. All of the work for those replacements has been performed by Illinois Gas personnel. The Company also has been replacing approximately 10% of its meters per year, for each of the past six years, with new, temperature compensated meters. Illinois Gas has also upgraded its odorization equipment and several distribution regulator stations.

Q. What action did Illinois Gas take to attempt to obtain proposals for financing of its long term debt?

A. On August 5, 1999, we sent packages to the following banks in our service territory:

Community Bank and Trust, NA, Olney, IL;
Peoples National Bank, Lawrenceville, IL;
Heritage National Bank, Lawrenceville, IL;
First National Bank, Bridgeport, IL;
First National Bank, Sumner, IL;

1 First National Bank; Olney, IL;
2 Olney Trust Bank, Olney, IL;
3 Bank of Lawrence County, Bridgeport, IL;
4 First Crawford State Bank, Sumner, IL; and
5 Sainte Marie State Bank, Sainte Marie, IL;

6 requesting their proposal for a \$2,200,000.00 mortgage and a \$1,000,000.00 line of
7 credit, both with a twenty year term. We received offers from Community Bank and
8 Trust, NA; First National Bank, Olney, IL; Peoples National Bank, Lawrenceville, IL; and
9 Bank of Lawrence County, Bridgeport, IL.

10 Roger C. Avery, President and CEO of Illinois Gas, and I reviewed all of the proposals.
11 Because all the proposals required that we maintain our primary accounts with that bank,
12 we evaluated the total costs of doing business (ie, interest expense, interest income,
13 collection fees, NSF Charges; closing costs, and courier costs). That analysis, which is
14 attached as Exhibit 3, was reviewed by the Company's Board of Directors, and they felt
15 that it was in the best business interests of the Company and its customers to obtain
16 financing through Community Bank and Trust, NA, which was the most economical
17 proposal.

18 Q. Why did the Company restrict its efforts to obtain financing proposals to its service area?

19 A. The Company believed that since its revenues are generated within its service area that it
20 would be in the best interest of its customers to secure the financing locally, provided the
21 costs of financing were competitive with larger banks not in the service area.

22 Q. Do you believe that the proposals received were competitive?

23 A. Yes, as all of the proposals were at prime interest or lower. We believe that this was a
24 direct result of these institutions having dealt with the Company for many years, and their
25 familiarity with our operations. This would not be the case with banks outside our service
26 area. Furthermore, as Illinois Gas is a privately held company, the process of evaluating
27 the financial status for banks without long term experience with the Company could be
28 costly and time consuming.

Q. Were there any other reasons for staying in your service area?

A. Yes. One of the requirements in all of the proposals received was that Illinois Gas utilize

1 the individual bank as its primary depository. Although we did not research the actual
2 costs, this would in several instances require hiring courier services to meet this
3 requirement. Logic would dictate that the longer the distance for such couriers, the larger
4 the cost.

5 Q. Would you please detail the particulars of the loan to be obtained through Community
6 Bank and Trust, NA, subject to the approval of this Commission?

7 A. Yes. One part of the \$3,200,000.00 loan package is in the amount of \$2,200,000.00, to
8 be repaid over a period of 20 years and secured by a mortgage on all utility property. The
9 \$2,200,000.00 loan will be subject to interest of 8.00% per annum for the first five years
10 of its term and the interest rate for the remaining fifteen years of the term will adjust
11 annually, at the anniversary date of the loan, to National Prime Rate, less one-fourth of
12 1%, or 25 basis points, as published in the Wall Street Journal as of the anniversary date of
13 the loan. The second portion of the loan package is a \$1,000,000.00 line of credit with a
14 20 year term, which is also secured by the utility property. The revolving line of credit
15 will be subject to interest at 8.00% per annum for the first five years, and then will also
16 adjust annually, at the anniversary date of the loan to National Prime Rate less one-fourth
17 of 1%, or 25 basis points, as published in the Wall Street Journal as of the anniversary date
18 of the loan. This proposal is attached as Exhibit 4.

19 Q. Do you believe that the financing proposal submitted by the Community Bank and Trust,
20 NA is in the best interest of Illinois Gas and its customers?

21 A. Yes, because it is the most economical proposal received based upon the analysis of total
22 business costs (Exhibit 3.) Although there was not a dollar value assigned, there will be
23 no courier costs as Community Bank and Trust, NA is the only bank that made a proposal
24 that has branches in both Olney, IL and Lawrenceville, IL, where the Company has
25 offices. Furthermore, as the Company is currently utilizing Community Bank and Trust,
26 NA for its primary accounts, there will be no costs associated with changing banks such as
27 printing checks and deposit slips.

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Q. You previously testified that the Revolving Note expired on August 2, 1999. What is the current status of the line of credit note?

A. That note has been extended to February 3, 2000, with an interest rate of 7.75%. Additionally, we have signed a renewal effective February 4, 2000, which will accrue interest at the rate of 8.25%.

Q. Will this financing, if approved, require Illinois Gas to change its rate structure in the near future?

A. No, we do not envision seeking rate relief due to this financing arrangement in the immediate future. Our present rate structure was approved by this Commission with an Order in Docket 98-0298 in September, 1998. That Order provided for returns based upon the following capital structure:

<u>Component</u>	<u>Amount</u>	<u>Ratio</u>
Short Term Debt	\$1,245,372	21.92%
Long Term Debt	1,760,283	30.99%
<u>Common Equity</u>	<u>2,675,381</u>	<u>47.09%</u>
Total	\$5,681,036	100.00%

The allowed return of 9.63% was detailed as follows:

<u>Component</u>	<u>Ratio</u>	<u>Cost</u>	<u>Weighted Cost</u>
Short Term Debt	21.92%	8.50%	1.86%
Long Term Debt	30.99%	8.28%	2.57%
<u>Common Equity</u>	<u>47.09%</u>	<u>11.05%</u>	<u>5.20%</u>
Total	100.00%		9.63%

Assuming full utilization of this financing, and growth in common equity (based upon the last ten years average as shown in Exhibit 5), our capital structure would be:

<u>Component</u>	<u>Amount</u>	<u>Ratio</u>
Short Term Debt	\$ 0	0.00%
Long Term Debt	3,200,000	55.38%
<u>Common Equity</u>	<u>2,577,673</u>	<u>44.61%</u>
Total	\$5,777,673	100.00%

This would allow a return of 9.35%, detailed as follows:

<u>Component</u>	<u>Ratio</u>	<u>Cost</u>	<u>Weighted Cost</u>
Short Term Debt	0.00%	0.00%	0.00%
Long Term Debt	55.38%	8.00%	4.43%
<u>Common Equity</u>	<u>44.61%</u>	<u>11.05%</u>	<u>4.92%</u>
Total	100.00%		9.35%

1 Management feels that this would be within an acceptable range, and would not require
2 immediate rate relief.

3 Q. Could you please summarize the Exhibits you are sponsoring for review by this
4 Commission?

5 A. Yes. The following Exhibits are attached for Commission Review:

<u>Exhibit</u>	<u>Description</u>
6 2	Short and Long Term Note Balances
7 3	Analysis of Long Term Debt Proposals
8 4	Community Bank and Trust Loan Proposal
9 5	Common Equity Balances

10 Q. Are there any additional costs to be incurred by the Company for securing this financing?

11 A. Yes. We estimate additional expenses as follows:

12 Closing Costs (legal fees and filing fees)	\$2,000.00
13 Legal Fees (document review and ICC 14 presentation)	\$2,500.00

15 Q. Does this conclude your testimony?

16 A. Yes, it does.

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